$50.00 ANNUALLY
40 Letters Per Year

DOW THEORY LETTERS

"The Market as Interpreted under the Dow Theory"

RICHARD RUSSELL
P. O. Box 15196
San Diego 15, California

Registered with the Securities and Exchange Commission

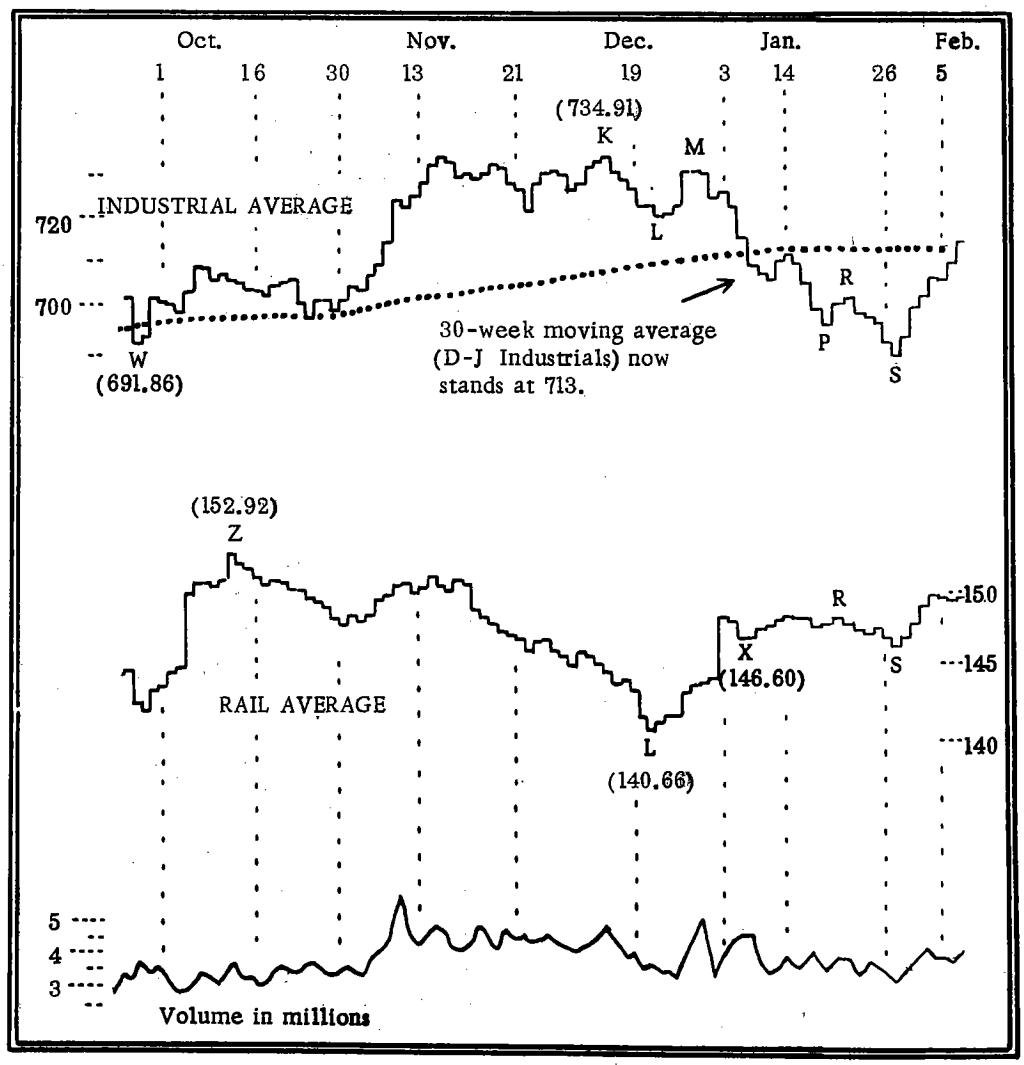
February 8, 1962 Number 170

THE MARKET From their all-time high of 734.91 (K-see chart) established last December, Industrials at S (689.92) lost 44 points. This correction erased 25% of the gains garnered since October, 1960. From their October, 1961 peak of 152.92 (Z), Rails at L lost 12 points, and this amounted to a 41% correction of the gains recorded since the October, 1960 low.

The 1961 Rail peak at Z was established approximately two months before the Industrial all-time high (734.91) at K. And as if to keep the long "out of gear" record intact, the Rail low at L (140.66) was recorded about a month before the recent Industrial low at S (689.92).

This week finds Rails in a well-defined upward zig-zag and only a few points from their 1961 peak of 152.92. Thus Rails (as of this writing) have recovered almost all of their Z-L losses. This week saw Industrials better their first minor peak at R, but the senior Average has made up only half of the losses sustained on the December-January decline. Consequently, the tedious pattern which has been discussed so many times in these Letters continues. And although the Averages have been displaying moods of alternate strength and weakness, at no time since March, 1961, have the two indicators either risen to new high ground together or retreated to new low ground together.

How long this technical stalemate can or will continue is anybody's guess. Suffice it to say that despite last week's improved action, this writer is far from convinced that the market has resolved all problems in favor of the upside.



At S we witnessed an interesting non-confirmation as Industrials dropped fractionally below their September low (691.86) while Rails held well above their own December low at L (140.66). In the last Letter I wrote: "A major (and bullish) non-confirmation would appear if Industrials violated their July (679.30) low while Rails held persistently above their own July low (133.49). Such an event would undoubtedly stir up a great deal of bearishness and would (as far as I am concerned) provide a much more advantageous trading 'buy-spot' than the current area". I continue to hold this view; moreover, I have expanded on this line of reasoning in the next section of this Letter.

CONCLUSION: The primary trend has been obscure for many

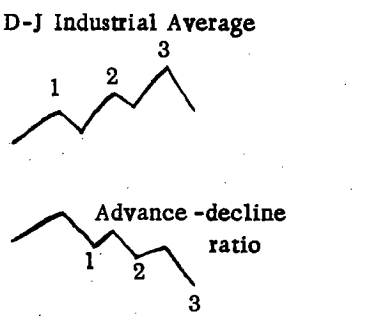
months -- it continues obscure now. An Industrial rise above the December high (734.91) with a Rail penetration of the 152.92 high would obviously mean that all trends were pointing up. Meanwhile, an Industrial retreat below the July (679.30) low with Rails holding above their own July low (133.49) would present a major non-confirmation and extremely interesting opportunity for longer range trading position.

In the absence of a final Industrial "clean out" below the July low, it would not surprise me to see a continuation of the apparently aimless fluctuations which have characterized the action of the market over the past ten months.

AN UNSOLVED PROBLEM A critical but little-understood "technical problem" is currently being played out by the advance-decline ratio (A-D ratio) and the Industrial Average. Although analysts throughout the country are now prone to issue fuzzy comments about the A-D ratio, it is probable that not a hundred people in the nation understand the full implications of what is occurring. The man who developed the A-D ratio and who has done the really important work on this indicator is James Hughes of New York. His recent article in Barron's was quite technical, and it provided the public with a rather large dose of information for one sitting. I am not sure that most people caught the full significance of Hughes' words, and I suggest that subscribers study the following paragraphs with great care.

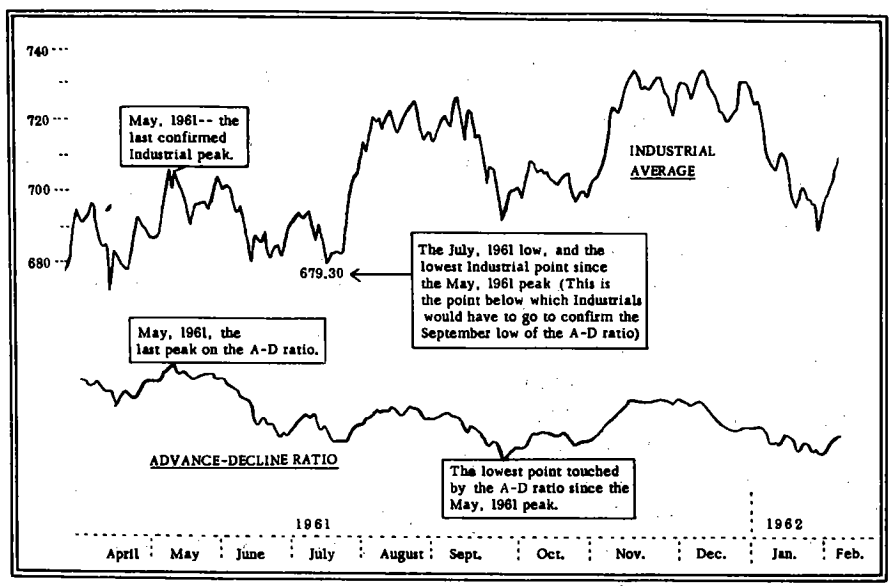
Since 1919, all major bear markets have been preceded by a series of divergent movements between the A-D ratio and the Industrial Average. These divergences consisted of three or more successive peaks on the Industrial Average, against which there occurred three or more successive decline lows on the A-D ratio (see small chart).

Since 1949, three such divergent periods have appeared, but instead of being followed by major bear markets, each of these periods was followed by a broad "trading range" and a final "clean-out" decline which took the Industrial Average to new lows for the entire move. These three final Industrial lows occurred in 1953, 1957 and 1960, and each served to confirm an extreme low recorded by the A-D ratio. By confirming the lows which were established by the A-D ratio, the Industrial Average was able to get back "in gear" with the A-D ratio. But instead of these final Industrial lows' being followed by further weakness (or major bear markets), each marked a final decline preparatory to an extended "New Era" advance to new all-time highs.

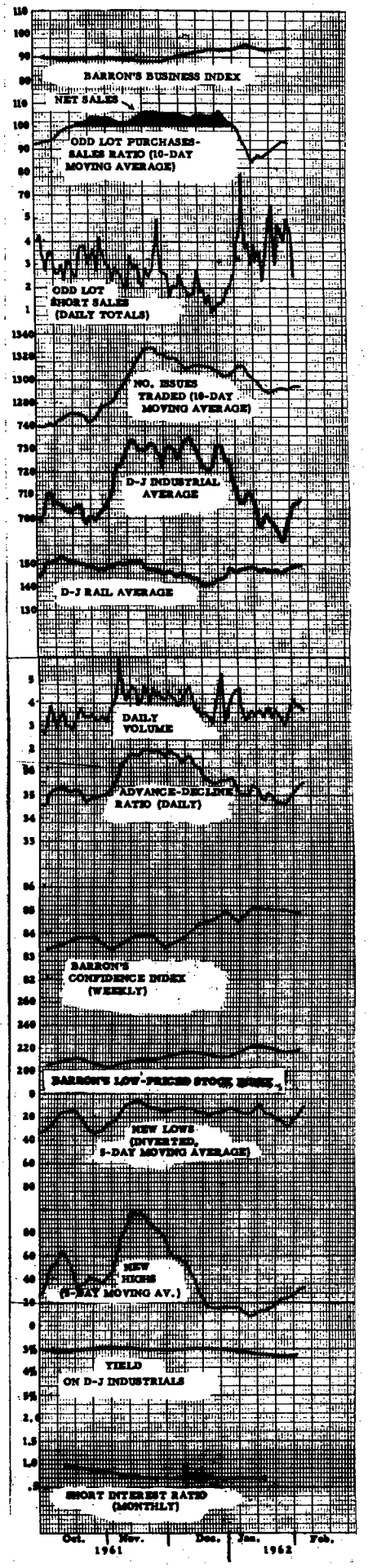


Since 1919, no major bear market has occurred unless preceded by the above formation. Nevertheless, the above formation has also been associated with secondary reactions and sub-normal bear markets.

Returning to the present, in May, 1960, both the A-D ratio and the Industrial Average established peaks (see chart). Although no classic divergence occurred at that time (i.e., the triple peaks mentioned above), both indicators turned down from their May highs and continued to react until July, 1961. A broad advance ensued, during which the Industrial Average climbed to an all-time high (in September). But the A-D ratio (see chart) failed by a wide margin to confirm the September Industrial high, and the market declined again. By the end of September, the A-D ratio had sunk under its July low (to the lowest level since January, 1961). The Industrial Average, however, refused to retreat below its own July low, and this non-confirmation set off another rally. Again Industrials rose to an historic high (December, 1961), and again the A-D ratio refused to confirm. The lack of confirmation in December gave way to the most recent decline, during which Industrials broke fractionally below their September low. But since the A-D ratio held above its own September low, another non-confirmation developed, and this gave rise to the most recent rally. Obviously, the series of non-confirmations must eventually be resolved or the market will remain in a trading range forever.



Two solutions now present themselves, each of which could resolve the current technical problem. (1) Both the Industrial Average and the A-D ratio could



rise to new highs since 1960. But the odds (based on the precedents of 1953, 1957 and 1960) do not favor this solution. (2) The second solution would be an Industrial decline whcih would take the senior Average at least fractionally below its July low of 679.30. Since the September low on the A-D ratio was the lowest point touched by that indicator since its May, 1961 high, and since the 679.30 (July) Industrial low was the lowest point struck by the senior Average since its won May high, an Industrial decline below 679.30 would have the effect of getting both the A-D ratio and the Industrial Average back in gear again. In other words, an Industrial penetration of the 679.30 July low would eliminate an eight-month series of non-confirming and divergent movements.

QUESTION: Suppose the Industrial Average now rises to an all-time high; where will that leave us?

ANSWER: If Industrials now rise to a new high, the odds are heavily against the A-D ratio's confirming (the A-D ratio is now too far from its own May, 1961 high--furthermore, the precedents of 1953, 1957 and 1960 militate against this resolution of the problem). A new unconfirmed Industrial high would also open the way for a possible bearish series of three divergences between the A-D ratio and the Industrial Average (which action could give rise to a major bear market). To sum up: the history of the relationship between the A-D ratio and the Industrial Average suggests that if the technical air is now to be "cleared", it will be cleared more easily by a further decline (by Industrials below 679.30), rather than an attempt at a major advance from this area.

INDICATORS Interesting changes in the major indicators are: (1) An area of fairly high odd-lot shorting, and a definite move by odd-lotters to less buying than was seen during the early weeks of January. Both phenomena are bullish, at least for the short-term. (2) Number of issues traded holding below 1300, suggesting a definite "cooling off" of market sentiment, compared to the excitement of early December (this indicator rises to peaks at important turns). (3) A rise in new highs to the mid-30 area, but this is still substantially below the November peak of 98. As might be expected, new lows have also contracted to below 20 after failing to expand past their November high figure of 35. (4) Barron's Confidence Index has held within a narrow range for six weeks. In all, the indicators show more strength than at any time in the last five weeks. I would not yet call the strength either decisive or tremendously impressive, however.

MUSINGS My friend Eliot Janeway points out an extremely interesting situation in his latest report. In the face of "the Administration's frustration over the rate of revenue receipts" and in the face of the current "bump against the debt limit", President Kennedy has now called for an investigation (and a halt or reversal) of the Government's stock-piling operations. Probably just a coincidence.....

LATE NOTES On today's closing (Wednesday, February 7), Industrials rose to 715.73, slightly above the halfway point of the entire K-S decline and approximately two points above their 30-week moving average. Rails are approximately 3 points under their 1961 peak of 152.92 (Z). Whether resistance will be offered by the 713 moving average area (on Industrials) and the 152.92 1961 peak area (on Rails) will shortly be seen.

ANNOUNCEMENT I am now carrying two additional books: (1) "Technical Analysis of Stock Trends" by Edwards & Magee. This is the definitive book on individual stock charting, and this volume should be studied by all who have even a passing interest in the technical approach to the market. The chapter on the Dow Theory in this book is superb. (Price - $12.00). (2) "Consistent Profits in the Stock Market"

by Curtis Dahl. This is the authoritative work on the use of the moving average in individual stock trading. I consider it one of the two or three truly important books on technical analysis of individual stocks. Both of these books are filled with dozens of interesting charts. (Price for Dahl book - $20.00. Please make checks out to Richard Russell Associates).

STOCKS Of the 56 "Key" stocks which I follow, 22 are now above their ten-week moving average, and this is an improvement of four over last week.

Of the stronger looking individual issues, I have included the daily charts of three stocks which seem to offer limited downside risk. National Distillers formed a long bass at 26. Celanese formed a base in the 32-36 area. Westinghouse Air Brake "bottomed-out" in the 24-26 zone. All three of these stocks appear to be trying for a clean "break-out" above their recent trading range. A "package" which included these three issues should outperform the market and be able to offer better than average resistance on declines. (These three charts courtesy of Traders Research, P.O. Box 2644, St. Louis 16, Mo.)

Written Thursday, February 8, at 10 A.M.